No. 88-1400

In The

Supreme Court of the United States

October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B.M. RARANG, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

Petitioners,

v.

ALCAN ALUMINIUM LIMITED AND IMPERIAL CHEMICAL INDUSTRIES PLC,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF OF AMICI CURIAE IN SUPPORT OF THE PETITIONERS BY THE STATE OF NEW JERSEY AND SEVERAL OTHER STATES

PETER N. PERRETTI, JR.
Attorney General of New Jersey
R.J. Hughes Justice Complex
CN 112
Trenton, New Jersey 08625
(609) 292-1537

MICHAEL R. CLANCY
Assistant Attorney General
Of Counsel

*MARY R. HAMILL
Deputy Attorney General
On the Brief
*(Counsel of Record)

(Continued on inside cover)

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or call collect (402) 342-2831

John Steven Clark
Attorney General of Arkansas

Duane Woodard
Attorney General of Colorado

Clarine Nardi Riddle
Acting Attorney General of Connecticut

Robert A. Butterworth
Attorney General of Florida

Warren Price, III
Attorney General of Hawaii

James T. Jones
Attorney General of Idaho

Illinois Department of Revenue
By: Neil F. Hartigan
Attorney General of Illinois

Lynley R. Pearson
Attorney General of Indiana

Thomas J. Miller
Attorney General of Iowa

Kansas Department of Revenue
By: Robert T. Stephan
Attorney General of Kansas

J. Joseph Curran, Jr.
Attorney General of Maryland

Hon. Hubert H. Humphrey III
Attorney General of Minnesota

William L. Webster
Attorney General of Missouri

Marc Racicot
Attorney General of Montana

Robert M. Spire
Attorney General of Nebraska

John P. Arnold
Attorney General of New Hampshire

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Attorney General of New Mexico

Nicholas J. Spaeth
Attorney General of North Dakota

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Attorney General of Ohio

Dave Frohnmayer
Attorney General of Oregon

Ernest D. Preate, Jr.
Attorney General of Pennsylvania

James E. O'Neil
Attorney General of Rhode Island

Roger A. Tellinghuisen
Attorney General of South Dakota

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Attorney General of Tennessee

Jim Mattox
Attorney General of Texas

R. Paul Van Dam
Attorney General of Utah

Jeffrey L. Amestoy
Attorney General of Vermont

Mary Sue Terry
Attorney General of Virginia

Kenneth O. Eikenberry
Attorney General of Washington

Donald J. Hanaway
Attorney General of Wisconsin

Joseph B. Meyer
Attorney General of Wyoming

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INTEREST OF AMICI CURIAE

This brief in support of California's petition for a writ of certiorari is submitted on behalf of the States of New Jersey, Arkansas, Colorado, Connecticut, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maryland, Minnesota, Missouri, Montana, Nebraska, New Hampshire, New Mexico, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, Wisconsin and Wyoming pursuant to Sup.Ct.R. 36.4

Many of these states have tax systems that are substantively different from California's provisions at issue here. However, the amici share California's concern with two fundamental questions before this Court, namely, who may challenge the validity of state taxes, and where may such challenges be waged? Prior to issuance of the Seventh Circuit's opinion, amici had presumed that the answers to these questions were obvious: the proper party to challenge the validity of a state tax is the party against

whom the tax is assessed, and relief should be sought by that party in the courts of the state levying the tax. The Court of Appeals for the Seventh Circuit, however, has taken just the opposite approach, ruling that state taxes levied against a corporate taxpayer may be challenged by a parent company-stockholder in the federal courts. The lower court concluded that such an action is not barred by principles of standing or comity, the Tax Injunction Act, 28 *U.S.C.* § 1341, or by the fact that the taxes in question have been imposed only upon the corporate taxpayer, which alone is legally liable for their payment.

The decision below permits unwarranted federal intrusion in state tax matters, thus threatening the integrity and effectiveness of state tax administration. The amici states therefore urge that certiorari be granted.

SUMMARY OF ARGUMENT

This case presents more than a narrow, technical standing issue. It raises important questions of law, comity and federalism.

Until the Seventh Circuit's decision in this case, the federal courts had adhered to the general rule that a stockholder cannot complain of wrongs inflicted on the corporation and had held that a foreign corporate stockholder lacked standing to challenge the constitutionality of state taxes assessed against its domestic subsidiary. The Seventh Circuit's opinion directly conflicts with these precedents. Moreover, the Seventh Circuit's opinion conflicts with the policies of federalism and comity inherent in the

Tax Injunction Act. The opinion permits a corporate stockholder to sue in federal court to challenge a state tax, which is precisely what the Tax Injunction Act is intended to prevent. This result is flatly inconsistent with the Court's cases, which have strictly construed the Tax Injunction Act to prevent federal court jurisdiction in state tax cases.

If allowed to stand, the Seventh Circuit's decision will have serious ramifications. First, the decision will lead to forum shopping and encourage maneuvering from one federal court to another to obtain standing, a process bound to result in an unequal administration of the laws. This case itself arose as a result of forum shopping, for the respondent foreign parent corporations could not have pursued these actions successfully in the Ninth Circuit, the circuit which encompasses the state which has imposed the taxes. Nor could the respondent foreign parent corporations have pursued these actions successfully in the Second Circuit, where a specific decision involving respondent Alcan already had been handed down against Alcan. Second, the ability of the states to administer their taxes without the threat of federal injunctions will be seriously eroded for federal jurisdiction will be available to a corporate stockholder claiming injury on account of state taxes imposed on its subsidiary. Third, actions of this type are likely to proliferate in federal court because the Seventh Circuit's reasoning would apply as well to a domestic corporate stockholder asserting that it owns its domestic subsidiary as an "instrumentality" of interstate commerce such that the normal rules of standing do not apply to bar suit by a stockholder for injuries suffered by the corporation.

ARGUMENT

POINT I
CERTIORARI SHOULD BE GRANTED BECAUSE THE SEVENTH CIRCUIT'S OPINION CREATES A CLEAR CONFLICT AMONG THE CIRCUITS.

It is the general rule that a stockholder cannot complain of injuries that are the indirect result of wrongs against the corporation. *Pittsburg & W. V. Ry. Co. v. United States,* 281 *U.S.* 479, 486-87 (1930). The rationale for this rule is that a stockholder is not personally injured by a wrong done to the corporation because his rights are derivative. *Id.* at 487-88.

On three previous occasions, circuit courts have adhered to this general rule and denied standing to a foreign parent corporation seeking to contest the constitutionality of state taxes assessed against its domestic subsidiary. Standing was denied in two decisions rendered by the Ninth Circuit: *Shell Petroleum, N.V. v. Graves,* 709 *F.*2d 593, 595-96 (9th Cir. 1983), *cert.* den. 464 U.S. 1012 (1983), and *EMI Ltd. v. Bennett,* 738 *F.*2d 994, 996-99 (9th Cir. 1984), *cert.* den. 469 *U.S.* 1073 (1984). Similarly, a New York district court held, and the Second Circuit affirmed, that a foreign parent corporation lacked standing to sue a state to challenge the state tax treatment of a domestic subsidiary. *Alcan Aluminum Ltd. v. Franchise Tax Bd. of Cal.,* 558 *F. Supp.* 624, 628-29 (S.D.N.Y. 1983), aff'd mem. 742 *F.*2d 1430 (2d Cir. 1983), *cert.* den. 464 *U.S.* 1041 (1984).

The Court of Appeals for the Seventh Circuit has conceded in its opinion that its holding on the standing issue creates an "arguable conflict" with the two decisions of

the Ninth Circuit. *See* Pet. App. at A1; *see also* Pet. App. at A17 n.12. Amici submit that not only does the decision below create a clear conflict with the Ninth Circuit but also a clear conflict with the Second Circuit. This conflict is not merely a conflict in dicta or in the general principles utilized in these cases. It is a direct, real and intolerable conflict over how the rules of standing are to be applied by different circuits given identical facts.

Until such time as this clear conflict between the circuits is resolved, the basic question of standing to litigate the constitutionality of a state's taxing system will depend solely upon which circuits have venue. Many states in addition to California have tax offices outside their boundaries,* and several have such offices in Chicago within the venue of the Seventh Circuit. Thus, until such time as the present conflict among the circuits is resolved, those desiring to question the validity of a particular state tax obviously will be tempted by the "virtues" of forum shopping. This is the inescapable consequence of having the Seventh Circuit recognize standing on the part of a corporate stockholder while the Second and Ninth Circuits do not. Amici states respectfully urge this Court to resolve the conflict before the Seventh Circuit's decision spurs further litigation.

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*A survey undertaken by the State of Minnesota in 1986 listed the following states, in addition to California, as having out-of-state audit offices: Alaska, Colorado, Florida, Illinois, Indiana, Iowa, Louisiana, Maryland, Massachusetts, Michigan, Missouri, New York, Nevada, Oregon, South Carolina, Tennessee, Washington and Wisconsin. Subsequently, Minnesota, New Jersey and Ohio have established out-of-state audit offices.

POINT II

CERTIORARI SHOULD BE GRANTED TO REVIEW THE IMPORTANT ISSUE OF WHETHER THE TAX INJUNCTION ACT APPLIES TO FEDERAL SUITS BROUGHT BY THE SOLE OR CONTROLLING STOCKHOLDER OF A CORPORATE TAXPAYER.

The Tax Injunction Act prohibits district courts from enjoining, suspending or restraining state taxes "where a plain, speedy and efficient remedy may be had in the courts of such State." 28 *U.S.C.* § 1341. The Seventh Circuit held in the instant case that the Act does not bar a foreign parent corporation from bringing an action to enjoin the collection of a state tax imposed on its subsidiary. The court reasoned that comity and federalism cannot justify withholding federal jurisdiction from a party with no cause of action in state court to redress its own direct and independent injury.

The opinion of the Seventh Circuit is out of step with many opinions of this Court which have recognized "the dangers inherent in disrupting the administration of state tax systems." *California v. Grace Brethren Church*, 457 *U.S.* 393, 410 n.23 (1982). As Justice Brennan has explained:

> The special reasons justifying the policy of federal noninterference with state tax collection are obvious. The procedures for mass assessment and collection of state taxes and for administration and adjudication of taxpayers' disputes with tax officials are generally complex and necessarily designed to operate according to established rules. State tax agencies are organized to discharge their responsibilities in accordance with the state procedures. If federal declaratory relief were available to test state tax assessments, state tax administration might be thrown into disarray, and taxpayers might escape the ordinary procedural requirements imposed by state law. During the pendency of the federal suit the collection of revenue under the challenged law might be obstructed, with consequent damage to the State's budget, and perhaps a shift to the State of the risk of taxpayer insolvency. [*Perez v. Ledesma*, 401 *U.S.* 82, 128 n.17 (1971) (concurring and dissenting in part)].

See also Fair Assessment in Real Estate Ass'n v. McNary, 454 *U.S.* 100, 108 n.6 (1981).

The Seventh Circuit has ignored the dangers alluded to in *Grace Brethren Church* and has interpreted the Act without regard to its principal purpose: "to limit drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes." *Rosewell v. LaSalle National Bank*, 450 *U.S.* 503, 522 (1981). The opinion of the Seventh Circuit also runs contrary to what this Court has characterized as the "historical reluctance of the federal courts to interfere with the operation of state tax systems if the taxpayer had available an adequate remedy in the state courts." *California v. Grace Brethren Church, supra*, at 412. The opinion of the Seventh Circuit looks only to the technical language of the Act and concludes that it does not apply to a non-taxpayer because a non-taxpayer has no state remedy. It thus gives preference to a party who is not even part of the taxing process. And it does so despite the fact that the party complaining of the state treatment has full control over the pursuit of the state remedies by the actual taxpayer.

This Court has stated that in order to be "faithful to the congressional intent 'to limit drastically' federal-

court interference with state tax systems, [the courts] must construe narrowly the 'plain, speedy and efficient' exception to the Tax Injunction Act." *California v. Grace Brethren Church, supra,* at 413. The Seventh Circuit in its opinion has departed from this rule of narrowly construing the exception and in doing so has encouraged interference by the federal courts in state tax matters. As the Court stated in *Great Lakes Dredge & Dock Co. v. Huffman*, 319 *U.S.* 293, 298 (1943) (quoting *Matthews v. Rodgers*, 284 *U.S.* 521, 525 (1932)):

> 'The scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts, and a proper reluctance to interfere by injunction with their fiscal operations, require that such relief should be denied in every case where the asserted federal right may be preserved without it.'
>
> . . .
>
> Interference with state internal economy and administration is inseparable from assaults in the federal courts on the validity of state taxation, and necessarily attends injunctions, interlocutory or final, restraining collection of state taxes. These are the considerations of moment which have persuaded federal courts of equity to deny relief to the taxpayer. . . .

In sum, the decision of the court below is incorrect because it fails to recognize that federalism and comity are the underpinnings of the Tax Injunction Act and that under decisions of this Court, the Act should be interpreted to further those principles. The net effect of the lower court's decision will inevitably be to expand the jurisdiction of federal courts at the expense of comity, federalism and states' rights.

POINT III

CERTIORARI SHOULD BE GRANTED BECAUSE THE SEVENTH CIRCUIT'S OPINION IMPROPERLY PERMITS FEDERAL INTRUSION IN STATE TAX MATTERS AT THE INSTIGATION OF A CORPORATE STOCKHOLDER.

The Seventh Circuit has concluded that the normal shareholder standing rules do not apply to a parent company seeking to challenge state taxes levied against a subsidiary company because the parent owns its subsidiary as an "instrumentality" of commerce. While the actual matter before the court involved a foreign parent in control of an American subsidiary, the court's reasoning apparently would apply to an American parent in control of a subsidiary as an "instrumentality" of interstate commerce. As a result, the doors of the federal courts have been thrown wide open to any corporation that is disenchanted with the state tax treatment of a subsidiary.

The Seventh Circuit erroneously has fashioned a new and extremely broad type of "injury" to confer standing in this case. Here the lower court found the parent corporations' independent injury in the "potential" of California's taxing method "to disfavor a particular mode of foreign participation in the American economy," which potential in this case "burden[ed] foreign companies' decisions to conduct business through subsidiaries operating in California. . . ." Pet. App. at A15-A16. It is difficult to see how any state tax provision which potentially disfavors "a particular mode of foreign participation in the American economy," such as a sales tax provision which favors the subsidiary's leasing of property over its out-

right purchase or sale of property, would not have the potential of requiring foreign corporations to make the same type of decisions that the Seventh Circuit defines as an independent injury sufficient to confer standing.

The end result of the Seventh Circuit's new standing rule appears to be that if the state tax statute gives any opportunity for tax planning by the foreign (or domestic) controlling parent, that opportunity is to be viewed as a burden that provides standing to the parent in the federal courts to challenge the taxes levied upon a subsidiary. But this sort of opportunity/burden arises solely from the potential for control which every majority stockholder exercises over every corporation it owns. Thus, California is correct in characterizing the Seventh Circuit's holding as a broad and erroneous departure from the established rule that denies standing to stockholders.

CONCLUSION

The issues addressed by the Seventh Circuit in its opinion do not affect only petitioner California but have ramifications far beyond the parties and facts in that opinion. For all of the reasons stated herein, amici curiae respectfully urge this Court to grant the petition for a writ of certiorari.

Respectfully submitted,

PETER N. PERRETTI, JR.
Attorney General of New Jersey

MICHAEL R. CLANCY
Assistant Attorney General
Of Counsel

* MARY R. HAMILL
Deputy Attorney General
On the Brief
* (Counsel of Record)

John Steven Clark
Attorney General of Arkansas

Duane Woodard
Attorney General of Colorado

Clarine Nardi Riddle
Acting Attorney General of Connecticut

Robert A. Butterworth
Attorney General of Florida

Warren Price, III
Attorney General of Hawaii

James T. Jones
Attorney General of Idaho

Illinois Department of Revenue
By: Neil F. Hartigan
Attorney General of Illinois

Lynley R. Pearson
Attorney General of Indiana

Thomas J. Miller
Attorney General of Iowa

Kansas Department of Revenue
By: Robert T. Stephan
Attorney General of Kansas

J. Joseph Curran, Jr.
Attorney General of Maryland

Hon. Hubert H. Humphrey III
Attorney General of Minnesota

William L. Webster
Attorney General of Missouri

Marc Racicot
Attorney General of Montana

Robert M. Spire
Attorney General of Nebraska

John P. Arnold
Attorney General of New Hampshire

Hal Stratton
Attorney General of New Mexico

Nicholas J. Spaeth
Attorney General of North Dakota

Anthony J. Celebrezze, Jr.
Attorney General of Ohio

Dave Frohnmayer
Attorney General of Oregon

Ernest D. Preate, Jr.
Attorney General of Pennsylvania

James E. O'Neil
Attorney General of Rhode Island

Roger A. Tellinghuisen
Attorney General of South Dakota

Charles W. Burson
Attorney General of Tennessee

Jim Mattox
Attorney General of Texas

R. Paul Van Dam
Attorney General of Utah

Jeffrey L. Amestoy
Attorney General of Vermont

Mary Sue Terry
Attorney General of Virginia

Kenneth O. Eikenberry
Attorney General of Washington

Donald J. Hanaway
Attorney General of Wisconsin

Joseph B. Meyer
Attorney General of Wyoming